

1
2
3
4
5 IN THE UNITED STATES BANKRUPTCY COURT
6 FOR THE DISTRICT OF ARIZONA
7

8 In Re

9 ARTHUR F. LYONS
10 RYANN N. LYONS,
11
12

Chapter 13

Case No. 2:08-bk-13657-SSC

13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
**MEMORANDUM DECISION RE
SECTION 1325 INTEREST RATE**

Debtors.

I. INTRODUCTION

This matter comes before the Court on an "Objection to Proposed Chapter 13 Plan and Confirmation Thereof" ("Objection") filed with the Court on October 17, 2008 by American Honda Finance Company ("Honda").¹ The Court conducted an initial hearing on December 2, 2008, and a subsequent hearing on December 16, 2008. Because of the legal issues presented, at the December 16 hearing, both parties requested that a briefing schedule be set by the Court, with no oral argument on the matter. Once the matter was fully briefed, the parties believed that the Court could dispose of the issues presented.² On April 17, 2009, the matter was deemed

1. This matter is decided under The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 "BAPCPA" (Pub.L.No. 109-8, §1501(b)(1), 119 Stat. 23, 216).

2. The Court ordered the parties to file a stipulated statement of facts by January 15, 2009, simultaneous opening memoranda of law by February 17, 2009, and simultaneous responsive memoranda of law by March 16, 2009. The deadlines were extended to March 16,

1 under advisement.

2 Taking into account the arguments of the parties, the documents filed, and the
3 entire record before the Court, the Court has set forth in this decision its findings of fact and
4 conclusions of law pursuant to Fed.R.Civ.P. 52, Bankruptcy Rule 7052. The Court has
5 jurisdiction over this matter, and this is a core proceeding. 28 U.S.C. §§ 1334 and 157 (West
6 2008).

7 8 II. FACTUAL BACKGROUND

9 On July 17, 2008, the Debtors, Arthur and Ryann Lyons (the “Debtors”),
10 purchased a 2008 Honda CRV (“Vehicle”) from Honda. They entered into a Motor Vehicle
11 Retail Installment Sales Contract (the “Contract”) and Purchase Money Security Agreement with
12 Honda to consummate the purchase. Honda agreed to provide financing to the Debtors in the
13 amount of \$24,035.92, with interest thereon at the rate of 16.25 percent per annum until the
14 obligation was paid in full.³

15 On October 6, 2008, the Debtors filed a voluntary Chapter 13 bankruptcy petition,
16 which was assigned Case No. 2:08-bk-13657-SSC, and a proposed Chapter 13 Plan (the
17 “Plan”).⁴ The Debtors, in their Schedules, listed Honda as holding a purchase money security
18 interest on the Vehicle.⁵ In the Plan, the Debtors sought retention of the Vehicle, and proposed
19 adequate protection payments of \$220.00 per month until confirmation of the Plan.⁶ In the Plan,
20 the Debtors stated that they owed Honda the amount of \$24,548 on the Vehicle, that the fair
21
22
23

24
25 _____
2009, and April 17, 2009, respectively, at the request of the parties.

26 **3.** See Claims Register, Claim No. 4-1.

27 **4.** See Docket Entry No. 6.

5. See Docket Entry No. 1, Schedule D.

6. See Docket Entry No. 6.

1 market value of the Vehicle was \$22,000, and that the \$24,548 obligation would be repaid in
2 full, with interest thereon at a rate of 7 percent per annum.⁷

3 Honda filed its Objection on October 17, 2008. The basis of the Objection was
4 that the proposed Plan sought to reduce the interest rate from the contractual rate of 16.25
5 percent per annum to a rate of 7.00 percent per annum. Moreover, Honda objected to the
6 proposed adequate protection payment, arguing that the payment amount should be \$246.00 per
7 month, which equaled 1 percent of the principal amount of its claim, instead of the Debtors'
8 proposed monthly adequate protection payment \$220.00.⁸

9 Although the Court conducted two hearings on the matter, the parties provided
10 little information beyond what was contained in the Objection and the Stipulated Facts. The
11 Court did, however, resolve Honda's adequate protection objection, by increasing the monthly
12 payment from \$220.00 to \$246.00. Since it is not a disputed issue of fact, the parties apparently
13 agree that the Debtors use the Vehicle for their personal use. It also appears that the Vehicle was
14 acquired within the 910 days of the Debtors' petition filing date. The parties restated their
15 positions on the appropriate interest rate to paid on the Vehicle, with the Debtors arguing that
16 they could reduce the Vehicle's interest rate to a market rate of interest, and Honda urging that
17 the Court adopt the contractual rate of interest set forth in the original Contract.

18 19 III. DISCUSSION

20 As previously discussed, the Court has already resolved the adequate protection
21 issue, and the Debtors will also amend their Plan to provide for maintenance or surrender of the
22 extended warranty coverage on the Vehicle. The extant issue is whether the Debtors may adjust
23

24
25 ⁷ The Debtor indicated in the proposed Plan that the estimated fair market value of the
Vehicle was obtained from Kelly Blue Book.

26 ⁸ In the District of Arizona, the debtor usually pays a proposed monthly adequate
27 protection payment equal to 1 percent times the value of the vehicle pending confirmation of the
debtor's Chapter 13 plan.

1 the interest rate to market, or whether the Debtors must provide for the originally contracted
2 interest rate.

3 A creditor has an allowed claim which is secured “to the extent of the value of
4 such creditor’s interest” in the subject property. 11 U.S.C. § 506(a)(1) . If the claim exceeds
5 the value of the property, the excess is classified as unsecured. Id. Under BAPCPA, Section
6 506(a)(2) has been added to focus on the individual debtor who files a case under either Chapter
7 13 or Chapter 7 and desires a determination as to the secured status of a creditor on personal
8 property. 11 U.S.C. § 506(a)(2) states that the value of the secured portion of a claim is “based
9 on the replacement value of [the personal property] as of the date of the filing of the petition.”
10 Any portion of the claim which exceeds the replacement value of the personal property is treated
11 as an unsecured claim. Thus, in this case, the Court must first determine the replacement value
12 of the Honda as of the filing date of the Debtor’s petition.

13 The Chapter 13 debtor must also comply with 11 U.S.C. § 1325(a)(5). With
14 respect to each secured claim, the debtor must propose one of the following in the plan of
15 reorganization: (1) the secured claimant must accept the plan, (2) the secured claimant must
16 retain the lien securing its claim, the value of any property to be distributed in payment of the
17 claim under the plan cannot be less than the amount of the secured claim, and if periodic
18 payments are made, such payments must be in an amount which assures the secured claimant is
19 adequately protected, or (3) the debtor must surrender the property securing such claim to the
20 secured claimant.

21 Under BAPCPA, however, Congress added a provision concerning a Chapter 13
22 debtor who proposes to confirm a plan of reorganization that treats the claim of an automobile
23 purchase-money secured lender. This unnumbered subsection, found after 11 U.S.C. §
24 1325(a)(9), is referred to as the “hanging” paragraph. The paragraph provides:

25 For purposes of paragraph (5), section 506 shall not apply to a
26 claim described in that paragraph if the creditor has a purchase
27 money security interest securing the debt that is the subject of the

1 claim, the debt was incurred within the 910-day [*sic*] preceding the
2 date of the filing of the petition, and the collateral for that debt
3 consists of a motor vehicle . . . acquired for the personal use of the
4 debtor

5 The paragraph, thus, applies to the individual debtor that utilized purchase-money
6 financing to acquire a motor vehicle for personal use within 910 days of filing his or her petition.
7 For purposes of this Decision, the parties agree that the Debtors utilize the Vehicle for their
8 personal use, and they acquired the Vehicle from Honda, through purchase-money financing,
9 within the 910-day period.

10 The courts which have interpreted the hanging paragraph have concluded that
11 application of the paragraph disallows debtors from bifurcating qualifying claims under Section
12 506. In re Trejos, 374 B.R. 210 (9th Cir. BAP 2007); Drive Financial Services, L.P. v. Jordan,
13 521 F.3d 343 (5th Cir. 2008); In re Wright, 492 F.3d 829, 832 (7th Cir. 2007); In re Brei, 2007
14 WL 4104884 (Bankr.D.Ariz. 2007). Thus, a debtor must pay the qualifying claim in full,
15 irrespective of the value of the collateral.

16 In this case, the parties agree that the Vehicle should be treated under the hanging
17 paragraph, and that the debt owing on the Vehicle may not be “crammed-down” to the Vehicle’s
18 replacement value. Accordingly, although the replacement value of the Vehicle is less than the
19 amount of Honda’s claim, since Honda provided the financing for the vehicle within 910-days of
20 the Debtors’ bankruptcy filing, the Debtors must either surrender the Vehicle or provide for full
21 payment of Honda’s claim. The Debtors have proposed such treatment of Honda’s claim in their
22 Plan. However, the Debtors have adjusted the interest rate associated with Honda’s claim from
23 16.25 percent to 7 percent per annum in the Plan. The remaining issue is whether the Debtors
24 may keep the Vehicle, yet alter the contractual interest rate originally negotiated between the
25 parties.

26 Although 11 U.S.C. § 1325(a)(5) does not explicitly provide for the payment of
27 interest on allowed claims in a Chapter 13 Plan, 11 U.S.C. § 1325(a)(5)(B)(ii) indicates that the
28

1 plan must provide for “the value, as of the effective date of the plan, of the property to be
2 distributed” The United States Supreme Court, in a pre-BAPCPA decision, interpreted this
3 phrase as requiring the payment of interest since “[a] debtor’s promise of future payments is
4 worth less than an immediate payment of the same total amount” Till v. SCS Credit Corp.,
5 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004).

6 In calculating the appropriate rate of interest, the Supreme Court applied the
7 “formula approach.”⁹ Id. at 478. Under the formula approach, courts are instructed to apply the
8 notional prime rate and adjust this rate by an appropriate risk factor. Id. at 479. The risk factor
9 is calculated by considering such factors as “the circumstances of the estate, the nature of the
10 security, and the duration and feasibility of the reorganization plan.” Id.

11 Honda posits two arguments as to why the Debtors must fail in their attempt to
12 lower the interest rate on Honda’s claim to the 7 percent proposed rate. First, as a result of the
13 enactment of BAPCPA, the Till decision is inapposite, and the Debtor must pay the contract rate
14 of interest on its claim. Although Till is still applicable to those debtors that are generally
15 proposing the treatment of a secured claim on personal property, the decision may not be so
16 expansively interpreted to dictate the results as to the newly enacted hanging paragraph.¹⁰
17 Second, Honda argues that even if the formula approach, as set forth in Till, is the appropriate
18 method for determining the applicable interest rate on a claim valued under the hanging
19 paragraph, the Debtors have not established that the contract interest rate is not the appropriate
20 interest rate.

21 Considering the first argument, Honda agrees with the Debtors that there are
22 courts which apply the Till formula approach to hanging-paragraph cases. Drive Financial, 521
23 F.3d 343 (5th Cir. 2008); In re Taranto, 365 B.R. 85, 91 (Bankr. 6th Cir. 2007); In re Estrada, 387
24 B.R. 875, 880 (Bankr.M.D.Fla. 2008); In re Phillips, 362 B.R. 284, 307 (Bankr.E.D.Va.2007); In

25 **9.** This approach is also commonly referred to as the “prime-plus” approach.

26 **10.** Honda in making this argument does not take the position that Till is no longer good
27 law in cases that do not involve the hanging paragraph.

1 re Henry, 353 B.R. 261, 263 (Bankr.D.Or.2006). However, Honda argues that those cases are
2 from other circuits and districts and are advisory only.

3 The post-BAPCPA courts which have continued to apply the formula approach to
4 hanging-paragraph cases reason that the only difference between the Till analysis and the
5 approach adopted in their cases is the Supreme Court bifurcated the creditor's claim pursuant to
6 Section 506. *See, e.g., Drive Financial*, 521 F.3d 343 (5th Cir. 2008); In re Henry, 353 B.R. 261
7 (Bankr.D.Or.2006). Upon bifurcating the claim under Section 506, the Supreme Court, in Till,
8 then conducts an analysis of how to calculate the interest rate to apply to the secured portion of
9 the claim under 11 U.S.C. § 1325(a)(5)(B). Since BAPCPA does not alter 11 U.S.C. §
10 1325(a)(5)(B), the courts have concluded that the portion of the Till decision based on 11 U.S.C.
11 § 1325(a)(5)(B) has not been impacted by the passage of BAPCPA and may still be utilized to
12 calculate the appropriate interest rate to be applied to hanging-paragraph claims. Drive
13 Financial, 521 F.3d 343 (5th Cir. 2008); In re Taranto, 365 B.R. 85 (6th Cir. 2007); In re Estrada,
14 387 B.R. 875 (Bankr.M.D.Fla. 2008); In re Phillips, 362 B.R. 284 (Bankr.E.D.Va.2007); In re
15 Henry, 353 B.R. 261 (Bankr.D.Or.2006).

16 Irrespective of the weight of authority against it, Honda nevertheless asks this
17 Court to follow the reasoning set forth in the decision of In re Brei, an Arizona bankruptcy
18 case.¹¹ The relevant language in the decision of In re Brei states:

19 the interest rate to be paid . . . is the contract rate, because since the
20 debt may not be crammed down, neither can the interest rate be
21 modified. Moreover, *no evidence was presented to show why the*
22 *10% contract rate was unreasonable or 'not a market rate' for this*
23 *particular [d]ebtor with this degree of 'risk.'*

24 **11.** In re Brei, 2007 WL 4104884 (Bankr. D. Ariz. 2007). Honda has also asked this
25 Court to expand the holding in the Panel decision of In re Trejos, 374 B.R. 210 (9th Cir. BAP
26 2007) to the facts in this case. However, the Panel clearly stated that it was not rendering a
27 decision as to the ability of a debtor to adjust the rate of interest on a hanging-paragraph claim,
as the creditor had failed to pursue the issue on appeal. The Court, thus, believes it inappropriate
to interpret a decision in the manner requested by Honda, since the appellate court determined
that the issue should be left unresolved. Honda's request is, therefore, denied.

1 (Emphasis Added). Honda reads In re Brei as requiring debtors to provide for full payment of
2 the contract rate of interest, regardless of any other considerations. While Honda focuses on the
3 court's initial statement that "since the debt may not be crammed down, neither can the interest
4 rate be modified," the second sentence seems to indicate that had the debtor provided some
5 evidence that the contract rate was "unreasonable" or not a market rate of interest, the court may
6 have come to a different conclusion. Accordingly, the In re Brei decision seems to provide for
7 an adjustment of the interest rate upon an appropriate evidentiary showing as to what interest
8 rate is appropriate.

9 In any event, this Court declines to follow the interest-rate analysis of In re Brei.
10 As noted by the weight of authority, Section 506 applies to a procedure to bifurcate claims when
11 a creditor with an allowed secured claim is also partially unsecured. Section 1325(a)(5)(B)
12 permits a creditor with a secured claim to receive an appropriate rate of interest on the claim to
13 ensure that the payments received by the creditor over the term of the Chapter 13 plan are equal
14 to the present value of the secured claim at the time of confirmation. In essence, the secured
15 creditor is not harmed. The hanging paragraph, however, refers only to Section 506, not Section
16 1325(a)(5)(B). Although a claim within the parameters of the hanging paragraph may not be
17 bifurcated, with the creditor to be paid the full principal amount of its claim, if the other terms
18 and conditions set forth in the hanging paragraph are met, there is no reference as to how interest
19 should be treated. This Court declines to expand the interpretation of the hanging paragraph to
20 force the payment of interest only at the contract rate when no such reference is made. The Till
21 case still applies to how interest should be computed as to the Debtors' repayment of Honda in
22 their Plan.

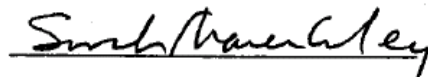
23 In its second argument, Honda posits that even if Till still applies to cases
24 involving the hanging paragraph, the appropriate rate of interest, in this case, is the contract rate
25 since the Debtors failed to establish that said interest rate "was unreasonable, or not a market rate
26
27
28

1 [of interest] for . . . [d]ebtors with this degree of risk.¹² While Honda relies on the decision of In
2 re Brei in support of its argument that the contract rate is presumed to be the appropriate rate of
3 interest unless the debtor rebuts this presumption, the Court disagrees with the reasoning in Brei.
4 From this Court's standpoint, there is no presumption in favor of the contract rate of interest, and
5 there is no discussion of such a presumption in the Till decision. Instead, the Court adopts the
6 Till formula approach, which directs courts to "start[] from a . . . low estimate and adjust upward
7" In applying the formula approach, the burden of proof, at an evidentiary hearing, is
8 squarely placed on the creditors. Till, at 479. Accordingly, since neither the Debtors nor Honda
9 have provided evidence to establish the appropriate interest rate to be paid on Honda's claim, the
10 Court must set another hearing on this matter.

11 12 IV. CONCLUSION

13 The Court concludes that the so-called hanging paragraph, set forth in Section
14 1325, only restricts the Debtors from bifurcating Honda's claim, and that the Till formula
15 approach must be used to determine the appropriate interest rate on said claim. Since the parties
16 have not provided any evidence to establish the appropriate rate of interest to be applied to
17 Honda's secured claim, the Court must set a further hearing on this matter, at which point the
18 appropriate rate of interest will be decided. A separate Rule 7016 scheduling conference will be
19 set in this contested matter by separate notice from the Court.

20
21 DATED this 13th day of May, 2009.

22 

23 Honorable Sarah Sharer Curley
24 U. S. Bankruptcy Judge
25

26

12. See Docket No. 47, Page 4.
27
28